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SUBJECT: SPAIN'S 2005 BUDGET TRIES TO BALANCE SOCIALIST GOALS WITH FISCAL RESPONSIBILITY

REF: MADRID 162

[1](#)1. SUMMARY: Vice President and Minister of Economy Pedro Solbes Mira presented the Socialist government's first General State budget to Congress on 30 September. After passing the Chamber of Deputies, the budget has been forwarded to the Senate for debate and approval. It will then be returned to the Chamber of Deputies for final approval. The budget reflects annual spending of approximately EUR 250 billion (USD 325 billion), an increase of 7.8% over the 2004 amount, and its surplus equals .1% of Spain's GDP. The two main objectives of the budget are increased social spending and increased productivity. The programs with the highest spending increases in Solbes' budget are: unemployment; civil research and development (R&D); affordable housing; and social security. Programs with decreased spending include: military R&D; subsidized transportation; and miscellaneous economic programs. The Solbes budget faces many challenges prior to approval, including an uncertain economic environment, the rising cost of petroleum, and tough negotiations with other political parties. END SUMMARY.

INTRODUCTION

[1](#)2. Vice President and Minister of Economy Pedro Solbes Mira presented the Socialist government's first General State budget to Congress on 30 September. Solbes' stated goal is budgetary stability while promoting productivity and increasing social spending. His budget reflects a projected income of approximately EUR 252 billion (USD 327.6 billion), an increase of 7.7% over the 2004 amount, and annual spending of approximately EUR 250 billion (USD 325 billion), an increase of 7.8% over the 2004 amount. The resulting proposed budget surplus equals .1% of Spain's GDP and can primarily be attributed to social security tax income.

APPROVAL PROCESS

[1](#)3. Spanish law requires approval of the budget from both houses of Congress prior to implementation. Solbes' budget has been debated within the Chamber of Deputies and various amendments have been proposed, with one costly R&D amendment approved to date. At this time, the budget has been forwarded to the Senate for its debate and approval process. The Senate should send the budget back to the Chamber of Deputies during the week of December 21st for final approval. If the budget proceeds through both houses of Congress according to the government's schedule, it should receive final approval during the last week of December. If the budget is not approved by the end of the year, the spending limits outlined in the 2004 budget will be carried over into [1](#)2005.

WINNERS

[1](#)4. A primary focus of the proposed budget is increased productivity. The proposed budget increases spending in the following areas: investment in infrastructure (up 9.1%); investment in civil R&D, which will double over the next four years (up 25.4% in 2005); and education (up 6%). The second focus of the proposed budget is social programs, with social spending increasing 9.5% and totaling slightly more than half of government spending. Key line items include: affordable housing programs (up 32.5%); unemployment (up 14.4%); social security (up 45.1%); and an increased allowance for pensions.

LOSERS

[1](#)5. The programs experiencing the greatest decreases in net spending include: miscellaneous economic programs (-1.1%); military R&D (-3.1%); and subsidized transportation (-12.7%). (Note: in the budget, the government takes on the debt of RENFE, the national train corporation. Although transportation will receive less money in the budget, all of its funding will go towards operational expenses as it no longer needs to make debt payments, thereby keeping

government's pledge to develop infrastructure.)

ECONOMIC CONTEXT

16. Solbes' budget is based upon a predicted 3% economic growth rate, an interest rate of 2% and petroleum costs of \$37 per barrel. Most Spanish economists describe this economic scenario as optimistic at the least. Local economists envision a less robust level of economic growth of around 2% and most predict a rise in interest rates in the near term, which may affect consumption. Lower economic growth rates will reduce government income and may cause a substantial gap between revenue and spending. Finally, petroleum costs are currently well above the budget's projected rate and could lead to a further consumption effect.

POLITICAL CONTEXT

17. Politically, Zapatero's government is a minority government requiring support of smaller regional parties to pass legislation through the lower house. To pass the Senate, which can only delay legislation, support of all minority parties is needed. The opposition Popular Party has criticized the government for bringing the budget to Congress without agreements already arranged. Costly amendments have already been added in areas like research and development. The government is currently negotiating with regional parties to prevent further delays and amendments from political parties seeking concessions in return for their support.

COMMENT

18. As the first budget of the Zapatero government, the 2005 budget is a crucial piece of legislation. Failure to pass the budget in a timely manner, or with serious controversy, would be a major embarrassment for both VP Solbes and PM Zapatero. It could also prevent the minority government from delivering on key campaign promises. The main challenge is whether the budget will escape Congress with most of the key goals intact. Budgetary concessions to political parties would compromise its fiscal soundness. The subsequent challenge is whether the economy will meet projected growth levels and provide the revenue necessary to meet budgetary needs.

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